The Washington Post
washingtonpost.com

A Section

Social Security Formula Weighed; Bush Plan Likely to Cut Initial Benefits

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1,154 words
4 January 2005
The Washington Post
FINAL
A01
English

The Bush administration has signaled that it will propose changing the formula that sets initial Social Security benefit levels, cutting promised benefits by nearly a third in the coming decades, according to several Republicans close to the White House.

Under the proposal, the first-year benefits for retirees would be calculated using inflation rates rather than the rise in wages over a worker's lifetime. Because wages tend to rise considerably faster than inflation, the new formula would stunt the growth of benefits, slowly at first but more quickly by the middle of the century. The White House hopes that some, if not all, of those benefit cuts would be made up by gains in newly created personal investment accounts that would harness returns on stocks and bonds.

But by embracing "price indexing," the president would for the first time detail the painful costs involved in closing the gap between the Social Security benefits promised to future retirees and the taxes available to fund them. In late February or March, the administration plans to produce its proposed overhaul of the system, including creation of personal investment accounts and the new benefit calculation.

"This is going to be very much like sticking your hand in a wasp nest," said David C. John, a Social Security analyst at the conservative Heritage Foundation and an ally of the president. "And the reaction will be similar."

In informal briefings on Capitol Hill, White House aides have told lawmakers and aides that Bush will propose the change in the benefits formula, an approach recommended by his 2001 Commission to Strengthen Social Security , according to congressional aides and lobbyists.

Currently, initial benefits are set by a complex formula that calculates workers' average annual earnings in their 35 highest-paid years and adjusts those earnings up from those years to reflect standards of living near that worker's retirement age. That adjustment is based on wage growth over that time span. Under the commission plan, the adjustment would be based instead on the rise of consumer prices.

The change would save trillions of dollars in scheduled expenditures and solve Social Security's long-term deficit, but at a cost. According to the Social Security Administration's chief actuary, a middle-class worker retiring in 2022 would see guaranteed benefits cut by 9.9 percent. By 2042, average monthly benefits for middle- and high-income workers would fall by more than a quarter. A retiree in 2075 would receive 54 percent of the benefit now promised.

While no decision has been made, allies and opponents expressed little doubt about where the president is heading.

"No decision has been made, but the administration is clearly leaning in that direction," said Michael Tanner, director of the libertarian Cato Institute's Project on Social Security Choice. "I don't think anything else is seriously on the table."

A former senior administration official who recently discussed Social Security strategy with Bush aides said the change in the indexing formula "is assumed to be a part of any final solution."

"You've got the bitter medicine of changing the indexing, but to go along with that you've got the sweetener of the accounts," the former official said.

"There will be price indexing," said John Rother, policy director of AARP, the powerful seniors lobby.

The White House has been slowly building the case for the change. Last year's Economic Report of the President, written by the Council of Economic Advisers and signed by Bush, uses the Social Security commission's primary proposal to advocate overhauling the retirement system. Last month, the council's chairman, N. Gregory Mankiw, fingered the current system of "wage indexing" as a primary culprit for Social Security's problems.

"A person with average wages retiring at age 65 this year gets an annual benefit of about $14,000, but a similar person retiring in 2050 is scheduled to get over $20,000 in today's dollars," Mankiw said in a speech at the American Enterprise Institute. "In other words, even after adjusting for inflation, a typical person's benefits are scheduled to rise by over 40 percent."

Opponents of the proposal have also been mobilizing. Under an inflation-linked formula, benefits would keep up with prices, but wage levels determine standards of living, Rother said. Social Security benefits currently equal 42 percent of the earnings of an average worker retiring at 65. Under the new formula, that benefit would fall to 20 percent of pre-retirement earnings. Future retirees would, in effect, be consigned to today's standard of living.

"It's like saying elderly people today should live at a 1940 standard of living," said Robert Greenstein, executive director of the liberal Center for Budget and Policy Priorities. "Part of our social contract has been to allow seniors to participate in rising standards of living rather than consigning them to some second-class status in retirement."

But proponents say the shift to price indexing has to be viewed with the addition of private accounts.

"If this was a case of just price indexing and doing nothing else, frankly, some of the [opponents'] charges are pretty valid," John said. "But if you give the personal accounts as well, you're giving people the opportunity to make up the difference. Not everyone will do that, but a substantial number will."

White House spokesman Trent Duffy said benefits under a revamped system should be compared with benefit levels that are possible under the current system, not benefit levels that are promised but cannot be financed. "A solution has to be compared to current law, and current law will guarantee huge tax increases or huge benefit cuts, or both," he said.

Administration officials point out that future retirees face two prospects: the amount of benefits the retirees were promised and the amount that can actually be paid.

If workers are allowed to divert four percentage points of their 12.4 percent payroll tax into personal investment accounts, future retirees would probably be able to raise their total benefits above the amount payable from taxes collected at that future time, according to the chief Social Security actuary. But those increased benefits still would not match the benefits currently being promised because future tax levels cannot keep pace with the rapid increase in the number of retirees.

A retiree in 2032 would see a promised monthly benefit of $1,343 drop to $1,231, an 8.3 percent cut from both the payable and promised levels. But by 2052, returns on personal accounts would push total benefits for a middle-income worker to 129.4 percent of the payable benefit, even though the total benefit would still be about 6 percent less than promised because of the rising number of retirees.

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